Federal Direct Student Loan Program
(CFDA No. 84.268)

I. Legislation

Higher Education Act (HEA) of 1965, Title IV, Part D, as amended (20 U.S.C. 11087a-1087h) (expires September 30, 1997).

II. Funding History

Fiscal Year	Appropriation
1993	0
1994	$55,726,000
1995	821,656,000
1996	243,720,000

III. Analysis of Program Performance

A. Goals and Objectives

The William D. Ford Federal Direct Student Loan Program (FDSLP) makes below-market, variable-interest rate, long-term loans to students attending postsecondary schools. In this program the government provides the loan funds directly to borrowers. This is different from the Federal Family Education Loan Program (FFELP) in which the government guarantees (insures) loans administered by lenders and state guarantee agencies.

The program was initially authorized as a demonstration pilot by the Higher Education Amendments of 1992. The Student Loan Reform Act of 1993, a part of the Omnibus Budget Reconciliation Act of 1993, authorized that the program be implemented on a phased-in basis.

Such a phase-in, according to the legislation, would be based on the total volume of new student loans; 5 percent in the first year, academic year 1994–95; 40 percent in the second year, 1995–96; 50 percent in the third and fourth years, 1996–97 and 1997–98; and 60 percent in the fifth year, 1998–99. After the 1995-96 year, the percentage of new student loans may increase if institutional demand for participation increases.

The Direct Loan Program is intended to remedy many of the problems that have developed in the past 25 years with the existing Federal Family Education Loan Program, primarily its complexity for schools and borrowers and its cost to the taxpayer. Students complete only one application, the Free Application for Federal Student Aid (FAFSA). There is no separate loan application to a bank. The school determines how much a student will need to borrow and electronically transmits all the required loan information to the Department of Education’s servicing contractor. When the loan is approved, the student simply signs a promissory note and the school credits the student's tuition account.

Students benefit by receiving their loan funds much more quickly and by knowing whom to contact for information. Schools benefit by gaining greater control over the loan process; they receive the loan funds electronically and receive tuition payments faster, thereby improving their cash flow.

In the first year of the program (1994–95), 104 institutions participated. In the second year (1995–96), 1,147 institutions participated (Source III.1).

B. Strategies to Achieve the Goals

Services Supported

There are four kinds of Direct Loans:

- **Federal Direct Stafford/Ford Loans** also called Direct Subsidized Loans. Students must demonstrate financial need to receive this type of loan. (The school determines financial need based on the information provided on a financial aid application.) The federal government pays the interest on these loans while students are in school at least half time and during certain periods, such as grace and deferment (a postponement of repayment).

- **Federal Direct Unsubsidized Stafford/Ford Loans** also called Direct Unsubsidized Loans. Students can get these loans regardless of financial need, but have to pay all interest charges.

- **Federal Direct PLUS Loans** for parents of dependent students to pay for their children's education. Parents are responsible for all interest charges.

- **Federal Direct Consolidation Loans** are one or more federal education loans combined into one new Direct Loan. One monthly payment is made only to the U.S. Department of Education. In certain circumstances, students who have loans under the FFEL Program may consolidate them into Direct Loans. Even defaulted loans may be consolidated if borrowers agree to repay the loan under the Income Contingent Repayment Plan or make other satisfactory arrangements to repay the loan.

Direct Loan interest rates are variable, and they are adjusted each year on July 1. The maximum interest rate for Direct Subsidized and Unsubsidized Loans is 8.25 percent; in 1995–96 the interest rate was 8.25 percent. For Direct PLUS Loans, the maximum interest rate is 9 percent; in 1995–96 the interest rate was 8.98 percent.

Institutional Participation

Table 1

Institutional Participation in Direct Loan Program, Award Year 1995–1996
(excluding consolidation loans)

Type of Institution	Number	Percentage of FDLP institutions	FDLP loans (millions)	Volume
Public 4-year	219	19%	$4,952	67%
Private 4-year	201	18	1,745	24
Public and Private 2-year	164	14	313	4
Proprietary	563	49	409	5
Total	**1,147**	**100%**	**$7,419**	**100%**

Source: III.1

Although table 1 shows that fewer four-year institutions than proprietary schools are participating in the FDSLP, public four-year institutions accounted for the largest share of loan volume at FDLP institutions.

Student Borrowing

The maximum amount a student can borrow each year for Direct Subsidized and Direct Unsubsidized Loans is:

	Dependent Student*	**Independent Student****
1st-year undergraduate	$2,625	$ 6,625
2nd-year undergraduate	3,500	7,500
3rd-year under graduate	5,500	10,500 graduate/professional
4th year undergraduate	NA	18,500

*A dependent student is one who does not meet any of the criteria for an independent student.

**An independent student is one who falls into at least one of the following categories: a student who is at least 24 years old, a married student, a graduate or professional student, a veteran, an orphan, a ward of the court, or a student with legal dependents other than a spouse.

The amount a student can borrow is also limited by the student's school costs, other financial aid the student may receive, and (in the case of Direct Subsidized Loans), the student's Estimated Financial Contribution. The overall limits for all subsidized and unsubsidized loans (including a combination of FFEL and Direct Loans) are as follows:

- $23,000 for a dependent undergraduate student,

- $46,000 for an independent undergraduate student, and

- $138,500 for a graduate or professional student (including loans for undergraduate study).

The parent of a dependent student can borrow up to the cost of the student's education minus other financial aid the student receives.

Note: All Direct Loans except Direct Consolidation Loans have an origination fee of 4 percent, which is subtracted proportionately from each loan disbursement. This money goes to the federal government to help reduce the cost of supporting these low-interest loans.

Table 2
Distribution of Borrowers of Direct Loan, 1994-95 and 1995-96

	1994-95	**1995-96**
Number of student borrowers	285,000	1,370,000
Number of parent borrowers	25,000	111,000
Number of consolidated borrowers	8,000	75,000
Total unduplicated borrowers	**318,000**	**1,556,000**
Number of direct loans	462,000	2,295,000
Loan amount borrowed	$ 1,750,000,000	$8,213,000,000
Average loan	$ 3,788	$ 3,579

Source: III.2

Repayment Plans

A major element of the design of the Direct Loan Program is provision for different repayment plans to meet the needs of borrowers. There are four ways to repay a Direct Subsidized Loan or Direct Unsubsidized Loan. Direct PLUS Loan borrowers may choose from the first three options. Borrowers can choose a plan to fit their financial circumstances and, as mentioned earlier, can change plans if their financial circumstances change.

1. ***Standard Repayment Plan***: This plan requires fixed monthly payments (at least $50) over a fixed period of time (up to 10 years). The length of the repayment period depends on the loan amount. This plan usually results in the lowest total interest paid because the repayment period is shorter than under the other plans.

2. ***Extended Repayment Plan***: This plan allows loan repayment to be extended generally from 12 to 30 years, depending on the total amount borrowed. Borrowers still pay a fixed amount each month (at least $50), but monthly payments usually will be less than under the Standard Repayment Plan.

This plan may make repayment more manageable, but borrowers will pay more interest because the repayment period is longer.

3. ***Graduated Repayment Plan***: This plan allows payments to start out low and increase every two years. This plan may be helpful to borrowers whose incomes are low initially but will increase steadily. A borrower's monthly payments must be at least half of what the borrower would pay under Standard Repayment. As in the Extended Repayment Plan, the repayment period varies generally from 12 to 30 years, depending on the total amount borrowed. Again, monthly payments may be more manageable because they are lower, but borrowers pay more interest because the repayment period is longer.

4. ***Income-Contingent Repayment Plan***: This plan bases monthly payments on the borrower's adjusted gross income (AGI) and the total amount of Direct Loans borrowed. The required monthly payment will not exceed 20 percent of the borrower's discretionary income. Discretionary income equals AGI minus an amount based on the poverty level for family size, as determined by the U.S. Department of Health and Human Services. As the borrower's income rises or falls each year, monthly payments are adjusted accordingly. Borrowers have up to 25 years to repay; after 25 years, any unpaid amount is discharged, but borrowers must pay taxes on the amount discharged.

Table 3

Graduated/Extended Repayment Limits

Amount of Debt	**Repayment Period may not Exceed**
Less than $10,000	12 years
$10,000-$19,999	15 years
$20,000-$39,999	20 years
$40,000-$59,999	25 years
$60,000 or more	30 years

C. Program Performance—Indicators of Impact and Effectiveness

A survey of Direct Loan institutions reported the following findings (III.3):

- The overall level of schools' satisfaction with the Direct Loan Program among participating institutions was very high. Ninety-two percent of Direct Loan institutions said they were either "*somewhat*" or "very satisfied."

- Improved service to borrowers was the frequently mentioned factor affecting schools' decisions to participate in the Direct Loan Program. This was consistent across all institutional categories. The following factors were most important to institutions in considering whether to apply for the Direct Loan Program:

  -- The ability to serve borrowers better, cited by 88 percent of institutions;

- -- Institutional control over the loan process, cited by 60 percent of institutions;
- -- Simplicity of administration, cited by 47 percent of institutions; and
- -- Predictability of funds, cited by 43 percent of institutions.

- Institutions reported that Direct Loan implementation required a small to moderate level of effort. Institutions rated the ease of the start-up process for the three major organizational units involved in implementation—the financial aid office, the business or bursar's office, and technical or computer support staff. On a five-point scale, with 1 indicating an easy transition and 5 indicating a difficult transition, institutions reported that the start-up activities:

  - -- Were "relatively easy" for the business office (2.2), and
  - -- "Required a moderate level of effort" for the financial aid office (2.8) and for the technical support staff (3.0).

Implementation was more difficult for two-year private institutions and for institutions that have multiple campuses, branches, or schools served by separate financial aid offices.

- Improvements were needed in the Direct Loan software (EDExpress) and in training, but schools were very satisfied with the Department of Education's responsiveness and support in implementing the Direct Loan Program.

Institutions were satisfied with the timeliness and usefulness of all Department of Education–provided services and materials for implementing the Direct Loan Program.

Schools rated their satisfaction with the Direct Loan Program on a scale of 1 to 5, with 1 representing the highest level of satisfaction and 5 representing the lowest.

- -- The overall rating for timeliness of Department of Education services was 1.6.
- -- The overall rating for usefulness of Department of Education services was 1.4.
- -- Servicing support received the highest rating of all the services 1.3.

- Institutions very satisfied with the Direct Loan Program tended to be dissatisfied with the Federal Family Education Loan Program.

An inverse relationship was found between high level of satisfaction with the Direct Loan Program and past satisfaction with the Federal Family Education Loan Program.

- -- Almost half (45 percent) of the survey respondents indicated that they were dissatisfied with the Federal Family Education Loan Program.

- -- Three of four institutions that indicated they were dissatisfied with the Direct Loan Program were "very satisfied" with the Federal Family Education Loan Program.

A survey of borrowers reported the following findings (III.4):

- Direct Loan borrowers with previous FFEL loans were more likely than FFEL borrowers with previous FFEL loans to cite their 1994–95 loan experience as "more positive" than their prior loan experience.

- The vast majority (over 80 percent) of Title IV borrowers perceived their 1994–95 loan origination process as “very easy” or “ somewhat easy”. No statistically significant differences were found between the Direct Loan and FFEL programs.

- Borrowers indicated relatively low awareness of the key terms and features of the loan programs. No significant differences in borrower awareness were found between the Direct Loan and FFEL Programs.

Direct Loan Program Performance Measures			
Goal: To successfully implement and manage the Direct Loan Program.			
Objective	**Indicators**	**Source and Next Update**	**Strategies**
Borrowers			
1. Provide flexible repayment options so that debt burden is eased and defaults are minimized.	**1.1 Program default rate.** The Direct Loan Program cohort default rate will not exceed 10%, i.e. comparable to FFEL target. Actual direct loan target rate will be established based upon performance trends in this maturing program. (Rates will be compared to other govt. and consumer loans.) *No current baseline available. The FY 1994 cohort default rate contains no direct loans. A minimum of 3 years of rate issuances is needed to determine baseline, as repayment portfolio is still very young and not reflective of total population in a mature portfolio.* **1.2 Cost of flexible repayment.** Impact will be budget neutral. Flexible repayment, under current credit reform accounting rules, are currently projected to show a cost savings.	1.1 Office of Postsecondary Education (OPE) data, annual, beginning in 1997. 1.2 Office of the Under Secretary's Budget Service, annual, 1997	• On an ongoing basis, monitor various aspects of the repayment options, including debt burden and default rates to assess the benefits of flexible repayment for the borrower and the taxpayer. • To minimize loss on defaults, OPE is seeking to obtain many new authorities to enhance our ability to collect on defaulted loans. These new capabilities we are seeking include the authority to (1) access data on employment from the states, (2) insure that state offset the salaries of their employees upon ED's request, and (3) access data from state licensing agencies.

Direct Loan Program Performance Measures			
Goal: To successfully implement and manage the Direct Loan Program.			
Objective	**Indicators**	**Source and Next Update**	**Strategies**
2. Maintain a high level of borrower satisfaction.	**2.1 Borrowers' overall satisfaction with Direct Loan Program**. Meet or exceed 1st-year borrower satisfaction levels. Borrower satisfaction will meet or exceed that of FFEL borrowers. *The baseline for overall satisfaction is under development. However, one measure of satisfaction with the direct loan program—"overall level of ease in obtaining a loan"—shows that 85% of direct loan student borrowers found the process to be somewhat or very easy, compared to 84% of FFEL student borrowers. Satisfaction measures related to borrowers in repayment need to be added.*	2.1 Macro, Inc., program evaluation, 1997	• Maintain or increase the current high level of borrower satisfaction; Assure the smooth running of the Direct Loan origination and servicing contracts.
Schools			
3. Continue to provide a streamlined loan delivery system to attract schools to participate.	**3.1 Satisfaction with aid delivery and burden.** The institutional Direct Loan participation rate will meet or exceed 38% for 1997/98, 45% for 1998/99 and 50% for 1999/00 and beyond. *Current Direct Loan participation rate is about 33%.*	3.1 OPE program data, annua, 1997	• A major key to attracting higher direct loan participation and maintaining their high level of satisfaction is our commitment to enhanced delivery. OPE is committed to continue to improve student aid delivery to achieve totally integrated student financial aid program processes and systems and be responsive to customer needs.

Direct Loan Program Performance Measures			
Goal: To successfully implement and manage the Direct Loan Program.			
Objective	**Indicators**	**Source and Next Update**	**Strategies**
4. Maintain a high level of school satisfaction.	**4.1 Schools' overall satisfaction with the Direct Loan Program.** Schools will maintain a high level of satisfaction with the program. Level of institutional satisfaction will meet or exceed satisfaction of FFEL institutions. (Will track as a 3-year average.) *In award year 1994-95, 90% of Direct Loan institutions were satisfied or very satisfied compared to 67% of FFEL institutions.* **4.2 Institutional retention rate.** Meet or exceed 95%. *Current retention rate is 99.7%. Last year's rate was 99.0%.*	4.1 Macro, Inc. program evaluation, 1996 4.2 Contractor, annual, 1997	• See previous strategy.
Effective program management			
5. Provide a program that is cost-effective for the taxpayer.	**OPE will closely monitor each of the default, delinquency, and collection rates indicators while striving toward continuous improvement. Any adverse trends will be carefully analyzed for development of appropriate management corrective action.** **5.1 Gross default rate.** The lifetime gross dollar cohort default rate projects future defaults over the life a loan cohort. *The rates for the FY '94-'96 cohorts are currently estimated at 14.3%, 15.3%, and 16.3%, respectively.*	5.1 Budget Service, annual, 1997	• Movement toward performance-based contracting will help to make the program more cost effective. The many default reduction and collection enhancing initiatives should help to contain program costs.

Direct Loan Program Performance Measures			
Goal: To successfully implement and manage the Direct Loan Program.			
Objective	**Indicators**	**Source and Next Update**	**Strategies**
	Note: the upward trend in projected rates here (and in loss rates below) is largely a result in a shift in the mix of participating schools. Since the program's initial year, many more proprietary and other higher default rate schools have joined the program. These rate increases were not unexpected. **5.2 Loss rate**. The loss rate (lifetime net default rate), projects the overall rate of the Department's liability for a cohort of defaulted loans after taking into account collections on defaulted loans. *The rates for the FY '94-'96 cohorts are currently estimated at 6.3%, 6.9%, and 7.4%, respectively* **5.3 Annual delinquency rate.** The delinquency rate will measure the dollar amount of loans "past due" as a percentage of dollars in repayment. *The baseline is being developed.*	5.2 Budget Service, annual, 1997	

Direct Loan Program Performance Measures			
Goal: To successfully implement and manage the Direct Loan Program.			
Objective	**Indicators**	**Source and Next Update**	**Strategies**
	5.4 Annual collection rate. The annual collection rate is a measurement of annual net default dollars collected divided by dollars in default. *This rate will be calculated as of 09/30/97. However, the portfolio will not reach sufficient maturity for the rate to be meaningful for the next few years.* **5.5 Administrative cost**. On a per unit basis, administrative costs will be benchmarked against other comparable programs, e.g. Sallie Mae. *Baseline under development* **5.6 Contractor performance.** All major deliverables will be produced on time, within budget, and meet an independent assessment of quality. *Prototype contractor report is under development.*	5.4 OPE data, annual, 1997 5.5 OPE/Budget Service, annual, 1997 5.6 Evaluation by OPE contract monitoring staff, monthly (exceptions reporting on deliverables and dollars), 1997	
6. Continue to provide strong fiscal management of the program.	**6.1 Positive audit findings.** No material internal control weaknesses identified in the Direct Loan portion of ED's Department-wide financial statement audit. *No material internal control weaknesses were identified in 1995 audit.*	6.1 Financial program audits, 1997	• ED is committed to assuring that our system design supports the accurate and timely reporting of direct loan financial transactions, with emphasis on financial balancing among various systems that support the program and maintaining of audit trails.

Please see also Office-Wide Performance Indicators for the Office of Postsecondary Education displayed in the Overview (OPS) to the postsecondary education programs.

IV. Planned Studies

Institutional and borrower surveys are one component of an overall evaluation of the Federal Direct Loan Program being conducted by Macro International under contract to the U.S. Department of Education. The goal of the evaluation is to assess the effectiveness of direct lending primarily in terms of simplified administration and customer satisfaction. Findings from this study are reflected in the Department's matrix of performance indicators for the Direct Loan Program. The surveys conducted as a part of this study, both of institutions and of borrowers, are designed to determine the level of customer satisfaction with the Federal Direct Loan and Federal Family Education Loan (FFEL) Programs. The study will run from 1993 through 1998.

V. Sources of Information

1. Program data

2. Direct Loan Program Cost, President's Budget FY 1988: Appendix (Washington, DC: Office of Management and Budget, February 1997)

3. *Survey of First-Year Direct Loan Institutions* (Calverton, MD: Macro International, August 1995).

4. *A Survey of Direct Loan Program and Federal Family Education Loan Program Borrowers* (Calverton, MD: Macro International, February 1997).

VI. Contacts for Further Information

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